

DEPARTMENT OF THE TREASURY - GENERAL

STATE INVESTMENT COUNCIL

State Investment Council's Policy Concerning Political Contributions and Prohibitions on Investment Management Business

Adopted New Rule: N.J.A.C. 17:16-4

Proposed: October 18, 2004 at 36 N.J.R. 4695(a)
Adopted: March 17, 2005 by the State Investment Council, William G. Clark,
Director, Division of Investment
Filed: March 18, 2005 as R. 2005 d. [], with **substantive and technical**
changes not requiring additional public notice and comment (see N.J.A.C.
1:30-6.3).

Authority: N.J.S.A. 52:18A-91.

Effective Date: April 18, 2005
Expiration Date: March 9, 2006

Summary of Public Comments and Agency Responses:

The following is a summary of the public comments received and the responses of the State Investment Council (the "Council"). The commenter is identified at the end of the each comment by a number which corresponds to the following list:

1. Lori Grifa, Esq.
Wolff & Samson PC
2. Rae Roeder, President
Communications Workers of America (CWA) Local 1033

1. COMMENT: The commenter asks the Council to clarify whether the restrictions of N.J.A.C. 17:16-4.3 apply to contributions by the parent company of an investment management firm or by the parent company's political action committee (PAC). The commenter recommends that N.J.A.C. 17:16-4.3 should only apply to contributions by the parent company's PAC if it is "controlled" by the investment management firm. The commenter sets forth a number of criteria by which to determine whether a parent company's PAC is controlled by an investment management subsidiary, including whether investment management professionals contribute to the PAC or have influence or authority over the recipients of PAC contributions. (1)

RESPONSE: The Council believes that the commenter's proposed limitation would be too restrictive, focusing solely on the investment management firm's control over the PAC, and not on the parent company's control over the investment management firm. The definition of "investment management professional" in N.J.A.C. 17:16-4.2 clearly

provides that “supervisors” of investment management professionals are subject to the provisions of the proposed rule. The parent company, and its executive or management committee, effectively supervise the investment management firm. Moreover, the purpose of the parent company’s PAC is to enhance the political standing of the investment management firm, as well as that of the parent. Any contribution by such PAC would thus constitute an “indirect” contribution by the investment management firm covered by N.J.A.C. 17:16-4.5.

The Council intended that the restrictions of N.J.A.C. 17:16-4.3 should apply to contributions by any person or entity that controls the investment management firm, including its parent company and the parent company’s executive or management committee, and to any political action committees that are intended to enhance the political standing of the investment management firm, including the PAC of its parent company. To clarify this intent, concurrent with this adoption, the Council is proposing to amend the definition of “investment management professional” in N.J.A.C. 17:16-4.2 to explicitly include the executive or management committee of an investment management firm’s parent company or of any other entity that controls the investment management firm, and to amend the description of entities subject to the rule’s restrictions on contributions in N.J.A.C. 17:16-4.3 to explicitly include the parent company and any other persons and entities that control the investment management firm and their respective PACs.

2. COMMENT: The commenter asks the Council to clarify whether the restrictions of N.J.A.C. 17:16-4.3 apply to contributions by non-investment management affiliates of the investment management firm. (1)

RESPONSE: The Council did not intend the restrictions of N.J.A.C. 17:16-4.3 to apply to contributions by non-investment management affiliates of the investment management firm. An affiliate of the investment management firm would not ordinarily “supervise” the investment management firm, nor would activities of the affiliate’s PAC be necessarily designed to enhance the legislative standing of the investment management firm. In a financial company with large numbers of employees who are New Jersey residents, it is likely that at least one non-investment management employee would make a contribution to a State legislator, gubernatorial candidate, or county committee. If the restrictions of N.J.A.C. 17:16-4.3 were expanded to include affiliates of an investment management firm, such a contribution could result in the disqualification of the entire company from managing money for the State. Such a result could have the practical effect of inducing major financial firms with a broad New Jersey presence to disband their PACs, excluding tens of thousands of New Jersey residents from a form of participation in the political process, or even to prohibit non-investment management employees from making contributions at their own initiative or at the behest of solicitors outside the investment management business. While the proposed rule is designed to discourage solicitation of contributions by investment management professionals and firms, the intent was not to discourage unsolicited contributions by New Jersey residents who are employees of financial services companies but are not related to investment management firms.

3. COMMENT: The commenter asks the Council to clarify that the definition of “investment management professional” in N.J.A.C. 17:16-4.2 does not include employees

of non-investment management affiliates of investment management firms who would not otherwise qualify as “investment management professionals” if they were direct employees of the investment management firm. The commenter requests the Council to amend the proposed rule to define the phrase “associated with an investment management firm” to include only a director, officer, employee or other agent of an investment management firm. (1)

RESPONSE: The definition of “investment management professional,” in N.J.A.C. 17:16-4.2, clearly excludes employees of affiliates who are not either: (1) engaged in the provision of investment management services; (2) involved in the solicitation of business for investment management services; (3) involved in the supervision of employees who are providing investment management services or soliciting business for such services; or (4) a member of the executive or management committee of an investment management firm. The Council therefore does not believe that an amendment to the definition is necessary.

4. COMMENT: The commenter claims that N.J.A.C. 17:16-4.3 does not eliminate the “funneling” of funds to local candidates, local parties or local election committees to be used for the betterment of an entire “party ticket” – including both State and local candidates. A further claim is made that funds may be contributed for use as “soft money” on Election Day. (2)

RESPONSE: N.J.A.C. 17:16-4.3 restricts the payment of “political contributions” and “payments to political parties” by investment management firms engaged by the Division. The term “political contribution” is defined to include, among other things, any gift of funds made “[f]or the purpose of influencing any election for State office.” This would include money contributed to local candidates, parties and election committees to support “party tickets” or for use as “soft money” on Election Day.

The term “payment to a political party” is defined to include, among other things, payments to “any political party or political committee organized in this State, including county and ‘independent’ committees.” This definition would restrict contributions to local parties or local election committees.

Therefore, N.J.A.C. 17:16-4.3, as originally proposed, covers the activities described by the commenter. To the extent that investment management firms attempt to engage in “wheeling” or “funneling” of political contributions or payments to political parties through third parties, such activities are prohibited by N.J.A.C. 17:16-4.4 (solicitations) or N.J.A.C. 17:16-4.5 (indirect violations). To clarify this point, concurrent with this adoption, the Council is proposing to amend Section 17:16-4.5 to prohibit any activities that would violate the provisions of N.J.A.C. 17:16-4.3 or N.J.A.C. 17:16-4.4 or otherwise circumvent the purpose of the rule.

5. COMMENT: The commenter claims that the proposed rule (including N.J.A.C. 17:16-4.5) does not restrict contributions to political action committees in other states which are then contributed to candidates and/or political parties in New Jersey. (2)

RESPONSE: The restrictions of N.J.A.C. 17:16-4.3(a)(4) apply to any contributions made to any political action committee controlled by the investment management firm.

The restrictions are not limited to contributions made to political action committees within the State, but apply to all contributions, provided that they are made for the purpose of influencing any election for State office.

6. COMMENT: The commenter asks how the Council will monitor and police the activities of investment management firms. (2)

RESPONSE: The Council and the Division of Investment will review the disclosures submitted by investment management firms. Moreover, pursuant to N.J.A.C. 17:16-4.7, a copy of each report received from an investment management firm shall be made public.

7. COMMENT: The commenter objects to the fact that there are no penalties for failing to report relevant contributions as required by N.J.A.C. 17:16-4.6, or for filing false reports. The commenter accuses the Council of adopting a policy of using “name and shame” alone as a penalty to deter violations by investment managers. (2)

RESPONSE: The Council does not have the authority to impose civil or criminal sanctions on persons who file incomplete or inaccurate reports under N.J.A.C. 17:16-4.6. N.J.A.C. 17:16-4.9, however, provides that each contract with an investment management firm shall provide that violation of the provisions of the subchapter by the investment management firm shall be cause for immediate termination of such contract. In addition, N.J.S.A. 2C:28-3 makes it a criminal offense to mislead a public servant by making any written false statement or omitting information necessary to prevent a statement from being misleading. Finally, investment management firms are highly regulated entities, subject to numerous federal securities laws and regulations.

The commenter quotes language from the original proposal noting that it could be argued that requiring transparency of contributions (“name and shame”) would by itself be a sufficient check against abuse. The original proposal itself rejected this approach. The Council also rejected this approach by adding strict contribution limits to the disclosure requirements otherwise required.

8. COMMENT: The commenter claims that the rule does not encumber the parent or affiliated companies of an investment management firm from donating to a political action committee, party, or candidate. (2)

RESPONSE: As discussed above, concurrent with this adoption, the Council is proposing to amend the definition of “investment management professional” in N.J.A.C. 17:16-4.2 to explicitly include the executive or management committee of an investment management firm’s parent company or of any other entity that controls the investment management firm, and to amend the description of entities subject to the rule’s restrictions on contributions in N.J.A.C. 17:16-4.3 to explicitly include the parent company and any other persons and entities that control the investment management firm and their respective PACs. For the reasons set forth above, the Council does not intend the rule to apply to affiliates, provided such affiliates do not provide investment management services.

Summary of Agency Initiated Changes:

1. The Council has corrected a typographical error in paragraph 3 of the proposed definition of “investment management professional” in N.J.A.C. 17:16-4.2 to convey that only supervisors of persons described in paragraphs 1 and 2 of the definition are within the scope of the paragraph. In the proposal, the language had inadvertently read “a supervisor *or* any person described in [paragraphs] 1 or 2.”

Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the Division of Investment are under the auspices of the State Investment Council, and are not subject to any Federal requirements or standards.

Text of Changes

Full text of the changes between the rules as proposed and as adopted follows (additions to proposal indicated in boldface with asterisks * **thus***; deletions from proposal indicated in brackets with asterisks * **[thus]***):

SUBCHAPTER 4. STATE INVESTMENT COUNCIL'S POLICY CONCERNING POLITICAL CONTRIBUTIONS AND PROHIBITIONS ON INVESTMENT MANAGEMENT BUSINESS

17:16-4.2 Definitions

...

"Investment management professional" means:

- 1.- 2. (No change).
3. Any person associated with an investment management firm who is a supervisor ***[or]*****of** any person described in 1 or 2 above, up through and including the Chief Executive Officer or similarly situated official; or
4. (No change from proposal.).

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